2/11/88 R9050-3A

TAX FOUNDATION'S VOL. 32, NO. 1 JANUARY 1988

TAX·FEATURES

Slow Growth, Modest Inflation Seen By Conference Board Economist for 1988

U.S. Endures Two Decades of Accelerating Tax Legislation; Wobbling in Federal Policy

The 22-year span between 1964 and 1986 has witnessed the most frequent and dramatic changes in the Federal tax system in history. Congress has enacted 16 major tax bills and dozens of lesser bills affecting Federal revenue levels. Of the 14 major tax acts presented in Table 1, five have, on balance, increased revenues, eight reduced them, and one, the Tax Reform Act of 1986 is estimated to be revenue neutral over the five-year period of 1987-91. The revenue amounts involved in these tax acts range from an estimated fiscal year reduction of $309 billion in 1990 under the original Economic Recovery Tax Act of 1981 (ERTA) to an estimated $60 billion increase in the same fiscal year under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

The individual, corporate, and total Federal revenue impact of major enacted legislation since 1964 appear in Table 1. Here the budget result of each tax act is presented in isolation without netting the effects of subsequent legislation. The total revenue impact includes all taxes and miscellaneous receipts and is also presented as a percentage of gross national product (GNP). The Office of Management and Budget prepares the budget effect revenue estimates each fiscal year for the purposes of the budget presentation. They measure only the direct effect of tax legislative changes on receipts, with "feedback" effect limited to the overall income forecast and its impact on receipts by major source. Unlike the original legislative intent estimates, budget effect estimates reflect actual economic experience or revisions in the economic forecast.

Tax Reductions

The Revenue Act of 1964 and the Economic Recovery Tax Act of 1981 were by far the largest

(Continued on page 2)

Economic Outlook for 1988

"The forecast has some good news and some bad news," economist Edgar R. Fiedler told some 275 attendees at the Tax Foundation's 39th National Conference in New York December 2. Fiedler, Vice President and Economic Counselor of The Conference Board, keynoted the conference's morning session with the traditional economic forecast for the coming year. Paul H. O'Neill, President and Chief Executive Officer of Alcoa and a member of the Tax Foundation's Shadow Committee on the Federal Budget, chaired the session.

"The good news," Fiedler observed, "is no recession and no accelerating in the current 4 percent inflation rate. The bad news is that neither I nor any of my fellow forecasters has any confidence in this forecast." "Even in the best of times, forecasting is a hazardous profession," he noted, adding, "This is the worst of times."

The Conference Board's number one economist advised the corporate executives attending the Conference, "Keep your powder dry. That is, keep your company's plans flexible, ready to switch to a strategy suitable for either a weaker or a stronger economy in 1988 as the unfolding statistics reveal it, because right now, you can't trust your forecaster."

Nevertheless, Fiedler dutifully provided estimates of the major economic indicators for 1988, including: 2 percent increase in real GNP, 4 percent inflation, unemployment rising from about 6 percent now to 6 1/4 percent, or a little more, by the end of 1988, and interest rates not moving very much. "My own bet would be that interest rates will go up from here rather than go down, but not very far," he said.

Deficits — A Double Threat

While Fiedler conceded that the budget deficit is "a very serious issue for the performance of the economy over the next decade or two," he questioned that it had much to do with the October 1987 collapse of the stock market. Rather, he argued, "longer term massive deficits pose two serious threats that cannot be ignored." In the first place, such deficits "present a constant temptation to try to inflate our way out of the problem by monetizing the deficits." The second threat, which he cited as "not so dramatic . . . but just as debilitating," is "the drain on our supply of savings that would otherwise be avail-

(Continued on page 5)

THIS ISSUE:

PAGE 1:
Annual Conference
Recent Tax History
PAGE 3:
"Budget Watch"
PAGE 5:
"Front Burner"
INSERT:
Discouraging Tax Package

Table 1

Federal Revenue Impact of Major Enacted Tax Legislation, Fiscal Years 1964–1990

Individual, Corporate, and Total Impact and Percentage of GNP (a)

Budget Effect in Billions of Dollars (c)

	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Revenue Act of 1964	-2.4	-10.2	-15.3	-17.3	-18.3												
Individual	-2.4	-8.7	-12.4	-14.1	-15.5												
Corporate		-1.5	-2.9	-3.2	-3.2												
Total as a percent of GNP	-0.38%	-1.52%	-2.07%	-2.18%	-2.15%												
Revenue and Expenditure Control Act of 1968						16.0	7										
Individual						8.4	0.8										
Corporate						3.8	1.5										
Total as a percent of GNP						1.7%	0.47%										
Tax Reform Act of 1969							1.2	0.2	-1.1	-3.8	-5.4						
Total as a percent of GNP							0.12%	0.02%	-0.10%	-0.28%	-0.37%						
Revenue Act of 1971									-4.4	-6.9							
Individual									-1.9	-2.9							
Corporate									(b)	-1.7							
Total as a percent of GNP									-0.38%	-0.54%							
Tax Reduction Act of 1975												-10.2	-10.8	0.4	2.8	3.2	3.4
Individual												-9.4	-8.7	-0.6	-0.2	-0.1	-0.1
Corporate												-0.8	-2.0	1.0	2.9	3.3	3.6
Total as a percent of GNP												-0.67%	-0.64%	0.02%	0.13%	0.13%	0.13%
Tax Reform Act of 1976														-14.4	-13.2	-7.4	-8.0
Individual														-13.2	-8.7	-3.8	-3.9
Corporate														-2.6	-3.5	-2.4	-2.5
Total as a percent of GNP														-0.74%	-0.61%	-0.30%	-0.30%
Tax Reduction and Simplification Act of 1977														-2.6	-17.8	-13.7	-5.8
Individual														-2.1	-15.3	-11.3	-5.6
Corporate														-0.6	-2.5	-2.3	-0.2
Total as a percent of GNP														-0.13%	-0.82%	-0.56%	-0.22%

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988[d]	1989[d]	1990[d]
Revenue Act of 1978	-4.4	-21.7	-25.1	-29.0	-33.1							
Individual	-3.4	-15.3	-17.7									
Corporate	-1.0	-6.3	-7.3									
Total as a percent of GNP	-0.18%	-0.81%	-0.84%	-0.92%	-1.00%							
Crude Oil Windfall ProfitsTax of 1980		3.9	13.0	18.4	18.8	21.0						
Total as a percent of GNP		0.15%	0.44%	0.59%	0.57%	0.57%						
Economic Recovery Tax Act of 1981			-0.2	-35.6	-91.1	-135.8	-170.3	-209.8	-238.5	-258.7	-282.0	-309.4
Individual			-0.2	-25.2	-67.0	-101.3	-120.3	-142.2	-162.1	-179.6	-201.7	
Corporate			(b)	-9.5	-14.9	-22.4	-32.0	-43.9	-50.3	-51.8	-52.2	
Total as a percent of GNP			-0.01%	-1.13%	-2.74%	-3.71%	-4.32%	-5.08%	-5.40%	-5.47%	-5.56%	-5.69%
Tax Equity and Fiscal Responsibility Act of 1982					16.6	36.0	39.2	46.7	56.8	58.8	58.2	59.9
Individual					3.4	10.9	12.9	13.4	14.9	15.8	16.6	
Corporate					7.6	16.9	19.2	28.8	38.1	40.9	40.2	
Total as a percent of GNP					0.50%	0.98%	0.99%	1.13%	1.29%	1.24%	1.15%	1.10%
Social Security Admendments of 1983						5.7	8.7	10.2	12.1	24.6	31.0	23.8
Total as a percent of GNP						0.15%	0.22%	0.25%	0.27%	0.52%	0.61%	0.44%
Deficit Reduction Act of 1984						0.9	9.3	16.1	22.0	25.3	27.7	31.1
Individual						0.7	5.6	8.0	10.2	13.1	16.0	
Corporate						0.5	3.3	5.8	8.1	9.7	10.6	
Total as a percent of GNP						0.02%	0.24%	0.39%	0.50%	0.53%	0.55%	0.57%
Tax Reform Act of 1986									18.6	0.4	-11.7	-9.0
Individual									-10.6	-27.4	-38.8	-38.5
Corporate									28.2	25.0	23.5	25.4
Total as a percent of GNP									0.42%	0.02%	-0.23%	-0.17%
EXHIBIT												
Net budget effect of all major acts: 1981-1986								-132.4	-117.5	-136.4	-164.4	-193.1
Individual								-134.4	-157.0	-186.2	-216.9	-238.6
Corporate								-14.8	18.5	19.7	20.6	24.2
Total net 1981-1986 as a percent of GNP								-3.20%	-2.70%	-2.90%	-3.20%	-3.60%

(a) Totals include all taxes and miscellaneous receipts.

(b) Less than $50 million.

(c) Budget effect revenue estimates are prepared by the Office of Management and Budget for purposes of the budget presentation. They measure only the direct effect of tax legislative changes on receipts with "feedback" effect limited to the overall income forecast and its impact on receipts by major source. Budget estimates reflect actual economic experience or revisions in the economic forecast; the original legislative intent estimates do not.

(d) Revenue and GNP projections from the Fiscal Year 1988 Budget of the United States Government (Supplement), February 1987.

Source: Office of Management and Budget, Budget of the United States Government for fiscal years 1964 through 1988.

(TAX LEGISLATION, *from page 1*)

tax revenue reductions as a percentage of GNP. The Federal revenue reductions from the Revenue Act of 1964 amounted to over 2% of GNP in 1966, 1967 and 1968, due primarily to huge reductions in individual tax revenues and only modest corporate tax reductions. In 1968, the 1964 act produced a $15.5 billion reduction in individual tax revenues and an additional $3.2 billion in corporate tax reductions.

Not until 1981 did Congress again enact cuts reducing total Federal tax revenues by more than 2% of GNP. With ERTA in 1981, estimated 1983 total Federal revenue reductions amounted to 2.7% of GNP and would have reached almost 7% of GNP by 1990 – making it the largest tax cut in history for both individuals and corporations *if* it had been allowed to take effect fully. Congress devised ERTA's tax cuts to result in roughly an 80%-20% split between individuals and business

(Continued on page 8)

Budget Watch By Allen Schick

Lessons from the Budget Summit

Negotiating an arms control agreement with the Soviet Union is an easier task than negotiating a budget agreement between the President and Congress. For a full month, in October and November 1987, congressional leaders and presidential aides met day after day to iron out what appeared to be minor differences in revenue and spending policies. They finally hammered out an agreement that would, on paper, slice about $30 billion from this year's deficit and $46 billion from next year's. These seem to be big numbers, but when the smoke clears and the mirrors are taken away, what remains is *less* genuine deficit reduction than would have been accomplished by the automatic cutbacks of the Gramm-Rudman-Hollings (GRH) process.

The New GRH Mode — More Promises, Fewer Cuts

About a month before the budget summit, Congress revised the deficit and cutback targets of the Gramm-Rudman-Hollings process, The changes lowered the amounts by which the deficit had to be reduced, postponed the goal of a balanced budget until 1993, and limited this year's required deficit reduction to $23 billion. The new timetable was intended to defer tough decisions until after the 1988 elections.

Then came Black Monday, the 500 point drop in the Dow Jones index on October 19, 1987. Almost immediately, the President agreed to meet with congressional leaders to negotiate an agreement that would avert sequestration under GRH and calm the markets. At that point, everything seemed "greased" for a quick end to the protracted stalemate that had blocked action on the deficit. Pressure for a settlement was overwhelming and the dollar gap between the two sides appeared to be quite small.

. . . when the smoke clears, . . . what remains is less genuine deficit reduction than would have been accomplished by the automatic cutbacks of the GRH process.

The $23 billion that the negotiators had to find in deficit reduction amounted to barely one percent of combined federal revenue and spending. Moreover, deficit reduction was computed against an inflated baseline; any spending below the baseline was counted as a cutback, even if it was above this year's level. Nevertheless, the executive and legislative branches battled over the cutbacks for a month. The agreement they finally announced purported to do more by way of deficit reduction than GRH cutbacks would have. Table 1 summarizes the agreement; it shows how little was really accomplished.

This table, which is arranged differently than the one distributed by the negotiators, reveals that the main burden for reducing the deficit has fallen on tax increases and defense cutbacks. Including income from asset sales (which, in the arcane world of federal budgeting, are labelled "negative spending"), revenue increases account for more than half of the reported deficit reduction. On the spending side, almost half of the outlay reduction is accounted for by defense programs. Entitlements and discretionary domestic spending were hardly cut at all.

. . . the main burden for reducing the deficit has fallen on tax increases and defense cutbacks.

The tax increases and defense cuts are about the only amounts in the agreement that can be taken at face value. Tougher IRS compliance might generate additional revenue, but not because of what the White House Congress do on the budget. Asset sales should properly be regarded as a means of financing the deficit; they do not reduce the government's draw on capital markets. The promised entitlement cutbacks are just that — promises grounded in flaky estimates and sometimes used to hide program expansions which compel higher spending in the future.

(Continued on page 4)

Table 1
Budget Summit Agreement
($billions)

	1988	1989
Total Deficit Reduction	$30.20	$45.85
Revenue Increases	17.40	22.40
Taxes	9.00	14.00
User Fees & Other Charges	1.80	2.00
Tougher IRS Enforcement	1.60	2.90
Asset Sales	5.00	3.50
Outlay Reductions	11.60	19.95
Defense Cutbacks	5.00	8.20
Nondefense Discretionary Cuts	2.60	3.40
2% Pay Increase (counted as a cut)	–	2.40
Entitlements	4.00	5.95
Lower Debt Service	1.20	3.50

(Note: Estimated budget effects of the omnibus reconciliation bill as adopted in December 1987 differ marginally but not materially from this table.)

(BUDGET WATCH, *from page 3*)

An even more dismal appraisal of what the negotiators accomplished emerges from a comparison of the deficit reduction they agreed to and the reductions that would have been made if the Gramm-Rudman-Hollings sequestration were put into effect for the current fiscal year.

The so-called compromise shifted deficit reduction outlays to tax increases and opened the door to renewed use of gimmicks such as asset sales. Outlay reductions are only half the amount they would have been under the GRH process. Even if the agreement is fully carried out by Congress in enacting appropriations and other legislation, the deficit situation will continue to deteriorate.

Table 2
Comparison of GRH Sequestration To Summit Agreement FY1988
($billions)

	Sequestration	Summit Agreement
Tax Increases	$ 0.0	$ 9.0
Outlay Reductions	23.0	11.6
Asset Sales	0.0	5.0

- The actual fiscal 1988 deficit will almost certainly be higher than the 1987 deficit. It might be a lot higher if the economy slows down.
- The deficit for fiscal 1989 will probably be above the GRH target; if this occurs, there might be a need to sequester funds shortly before next year's elections.
- The GRH process will have to be revised again. There is no realistic possibility of meeting the deficit targets for 1990 and beyond.
- Record-breaking deficits of $250 billion and higher cannot be ruled out if the economy goes into a tailspin.

What Have We Learned from The Budget Summit?

All sorts of reasons have been offered for the failure of the budget summit: the impending elections; the split government which has put a Republican in the White House while giving the Democrats control of Capitol Hill; the "sacred cow" status of social security and other entitlements; the guns versus butter and the spending cuts versus tax increase battles that have raged through the 1980s. Excuses aside, the summit offers some important insights into the problems confronting the federal budget.

(1) *The budget stalemate mirrors contradictions in American public opinion.* A New York Times/CBS poll taken immediately after the summit agreement was announced reported that most Americans want a balanced budget but do not want to pay higher taxes or have the government cutback defense or social programs. This contradiction is not new, but dealing with it has been made more difficult by the relatively low growth of the past dozen years. The summit negotiators, like the American people, also tried to have it both ways, cutting the deficit without significant retrenchment in spending.

(2) *A big dent cannot be made in the deficit without making hard choices on social security and other transfers.* Entitlements comprise almost half of federal spending; add in interest charges and mandatory payments account for almost two-thirds of the total. When the negotiators took social security off the table, they eliminated any possibility of sizeable deficit reduction. Ironically, social security is perhaps the only part of the budget on the expenditure side for which a summit is necessary. Everything else can be dealt with through the regular presidential and congressional procedures.

(3) *A summit is no substitute for a workable budget process.* The budget process has been under extraordinary strain in recent years, with most of the year's work crammed into a gargantuan continuing resolution and a omnibus reconciliation bill. Compressing so many decisions into these two measures has been accompanied by a vast escalation of budgetary conflict between the two branches, and legislative gridlock in Congress. The summit was seen as a means of cutting through these conflicts; instead it escalated the political stakes and emphasized the deep divisions between Republicans and Democrats on the budget. While summitry has its place, there have to be quieter opportunities for making revenue and spending decisions through the everyday routines of the budget process.

The deficit for fiscal 1989 will probably be above the GRH target; if this occurs, there might be a need to sequester funds shortly before next year's elections.

(4) *The next President will have to grapple with the budget issues that the summit avoided.* It was not by accident that the summit worked out a two-year deal. Both the White House and Congress had a strong incentive to postpone tough decisions. The next President will not have it so easy. When he enters the Oval Office on January 20, 1989, he will find an envelope containing his predecessor's last will and testament. It will read, "Being of sound mind and body, I leave all my budget problems to you."

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Chairman of the Board ..... Hans W. Wanders
President ..... Robert C. Brown
Senior Vice President ... Edward A. Sprague
Editor ..... William J. Wilson
Contributing Editor ..... Allen Schick
Contributing Economist .... Paul G. Merski
Consulting Economist ..... Elsie M. Watters
Publications Specialist ..... William Ahern

Tax Foundation
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
(202) 822-9050

TAX FOUNDATION
ONE THOMAS CIRCLE, N.W., SUITE 500

WASHINGTON, DC 20005
TELEPHONE 202-822-9050

FEDERAL TAX POLICY MEMO

Editor: Edward A. Sprague, Senior Vice President—Program Planning and Tax Policy

JANUARY 1988

Tax Package Adopted; Process Sags Again

Late last month House and Senate conferees finally agreed on another patchwork tax increase incorporated as The Revenue Act of 1987 or Title X of HR 3545, the omnibus reconciliation bill. For weeks the outcome appeared inevitable, leaving only a massaging of particular provisions to fit targets predetermined by the budget "summit" of $9 billion and $14 billion in new revenues for FY1988 and FY1989, respectively.

Some of the most controversial provisions in the House or Senate bills were not adopted. The alternative minimum tax increase, the removal of the hospital insurance payroll base limit, the restriction of cafeteria plans, and most of the so-called "corporate control" items dropped out of the running. This had more to do with the time pressures on the conference and the need to concentrate on those items common to *both* plans than deliberate policy decisions.

While dodging some bullets, the corporate sector hardly escaped unscathed. Over $5 billion or 55 percent of the FY1988 overall tax increase, and $7.5 billion or 53 percent of the FY1989 increase, will come from business, mostly in bite sizes affecting individual industries or particular transactions. However, repeal of the vacation pay reserve, new funding rules for pension plans, restrictions on installment sales, and further cutback of the dividend received deduction all involve significant dollars. Some other provisions aimed at individuals and partnerships could have a negative effect on capital formation.

The Reconciliation Muddle

This is the fourth time since 1981 that the reconciliation process under the Budget and Impoundment Act of 1974 (as amended by Gramm-Rudman-Hollings) has been used in a significant manner to raise taxes. The results, obviously, are less than optimal.

Considering both the questionable spending reductions and haphazard tax legislating in this last round, it could be argued fairly that we would have been better off just letting the Gramm-Rudman-Hollings sequester take effect. At least the latter would have forced real spending cuts. Had not the "leadership" issue — the perceived need for the Administration and Congress to prove they could do *something* with a deficit reduction label on it — intruded so pervasively, we may well have been in sequestration now.

For tax policy the reconciliation process has produced:

- Lots of confusion
- An overburden on revenue estimating
- Submergence of policy considerations.

The rush to adjourn and the decision to go for base broadening the income tax — as opposed to new excises — inevitably resulted in another round of complication for tax administrators. They will have to grapple with dozens of new provisions before the Tax Reform Act of 1986 has barely cooled. Furthermore, except for two last-minute relief actions (for mutual fund shareholders and accountants), the year-long preoccupation with deficit reduction effectively blocked critical technical corrections to the Tax Reform Act of 1986 and other widely supported adjustments, such as for allocation of R & D expenses between foreign and domestic source income.

Constant pressure to come up with doses of new revenue is straining the capacity of the Joint Committee on Taxation to make reasonable estimates of specific provisions (regardless

The Vanished Corporate Tax Cut of 1981

Net Effect of Major Legislation On Corporate Income Tax Receipts FY1986–1990 ($billions)

	1986	1987	1988	1989	1990
Enacted 1981–1986[1]	−14.8	+18.5	+19.7	+20.6	+24.2
Revenue Act of 1987[2]			+ 5.0	+ 7.5	+ 7.7
			+24.7	+28.1	+31.9

[1] includes Economic Recovery Tax Act of 1981 (ERTA), Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Deficit Reduction Act of 1984 (DEFRA), Tax Reform Act of 1986 and some lesser acts.

[2] includes the following provisions as "corporate" effects: accounting provisions except dealing with partnerships; all corporate provisions under that heading; provision to modify pension funding rules; foreign tax provisions; insurance provisions; and estimated tax provisions.

Sources: Budget of the U.S. Government FY1988 and Conference Report on HR 3545.

Material in **Federal Tax Policy Memo** *may be reproduced freely. Credit to Tax Foundation would be appreciated.*

of one's view of the basic revenue estimating procedure used by both the Joint Committee and Treasury and its utility in measuring economic effects of multiple tax changes). Take the example of vacation pay revision. The initial revenue estimate for repealing the deduction for additions to vacation pay reserves was $235 million over three years. Affected taxpayers quickly recognized that the actual impact would be far greater – many times the initial estimate. Afterwards, the Joint Committee did raise its estimate to $3.1 billion for the three-year period and the provision was adopted.

In this case the more realistic later estimate probably helped avoid increasing taxes elsewhere and in this sense contributed to a better outcome. But if there had been no loud reaction to the original estimate, we could have ended up with both loss of the vacation pay deduction and, perhaps, the House alternative minimum tax proposal as well. Obviously, reasonable revenue estimates of multiple proposed provisions – some dealing with widely varying circumstances among taxpayers – cannot be assured. They especially cannot be assured in a pressure cooker of time constraints on the staff and legislators.

Revenue estimating has become part and parcel of the intent to inflict so much damage on – or grant so much relief to –particular economic sectors. Instead of following a policy direction to its logical revenue conclusion and perhaps then making adjustments elsewhere, we now start with a revenue "need" and try to juggle diverse provisions to fit. In the process, policy can easily get lost.

It surely did, for one example, in the case of lowering the corporate dividend received deduction from 80 percent to 70 percent where the ownership proportion is less than 20 percent. This was thrown in as a pure and simple grab from the corporate sector estimated at $1 billion over the next three years. In the House Committee report (there was no comparable Senate item), not a scintilla of policy justification was offered for a general cutback in the dividend received deduction other than a cursory statement that existing law is "too generous" for corporations that do not have sufficient ownership interest in the distributing corporation to qualify for the 100 percent deduction.

This completely ignores the double taxation of corporate income in the first place. Disregarding the Committee's points about certain dividends with non-stock characteristics, is there any real policy justification for anything *less* than a 100 percent dividend received deduction for any regular corporate investment in another corporation regardless of the ownership proportion? This latest move increases the relative tax penalty for doing business in the corporate form. It could constitute, in fact, a form of *triple* taxation when the 30 percent of dividend income subject to the penalty tax is distributed to individual shareholders.

Looking to 1988

One of the more distressing things about the current budget/tax situation is that there is no end in sight unless we get: (a) very lucky; or (b) seized with national determination to address the deficit squarely. Neither seems likely at least until the 1988 presidential campaign is disposed of.

For FY1989, the next budget year under consideration, the revised Gramm-Rudman-Hollings procedure requires deficit reduction from FY1988 of only $8 billion to a target level of $136 billion. The politicians naturally didn't want to face a long budget hassle in the fall of an election year. With the spending reductions/tax increases under the just adopted omnibus bill – designed to knock $45 billion off the FY1989 deficit from what it otherwise would be – the deficit target would *seem* to be obtainable. But this depends on both the planned spending reductions and anticipated revenue growth being realized. If the overall economy slows significantly, so will revenue growth and both the FY1988 and FY1989 deficits could rise significantly. Most private economic forecasts suggest that revenue growth in the 1988-1989 period will be more sluggish than implied by the Administration's current economic outlook. We could find ourselves right back in the same soup next summer and fall, facing the need for another round of tax bites and spending cuts or a Gramm-Rudman-Hollings sequester.

Going into recession or even an official *forecast* of recession would short circuit the Gramm-Rudman-Hollings procedure. And, supposedly, politicians don't raise taxes in election years or recession anyway. But they did in 1982 and we can't rule it out.

Recession or not, the type of tax increase that would be considered in an election year would very likely be the same as we just experienced. Tax rate increases are surely out of the question and despite Bruce Babbitt's lonely stand, nobody else seems to be taking a new consumption tax seriously at this point. Nicking the business sector and upper income individuals would again be the path of least resistance.

If tax actions, such as under the Revenue Act of 1987 and quite possibly again in 1988, help dress up the budget temporarily, they may well be counterproductive of the central purpose of long-term deficit reduction. That is to cut back government's drag on overall savings, encourage private saving to fill investment needs and concurrently reduce our reliance on foreign borrowing. Raising taxes on business and capital appears to be a peculiar way to go about it.

* * *

Perhaps *after* the 1988 election, realization of the futility of current tax policy will sink in. And regardless of the direction of tax policy in economic terms, there simply *has* to be a better way to conduct the legislative process. Rolling all tax and spending legislation into a huge year-end ball that careens over all other concerns is making any policy judgments much harder to make and more easily frustrated.

(CONFERENCE, *from page 1*)

able to finance new capital formation. You're all familiar with the phrase 'crowding out.' That's what I'm talking about here."

The Budget Monster

"Taming the Budget Monster" occupied the rest of the morning, with presentations by White House policy analyst Bruce Bartlett; Harvey Galper, Associate National Director for Tax Analysis, Peat Marwick Main & Co.; and Allen Schick of the University of Maryland, who is also a member of the Tax Foundation's Shadow Committee on the Federal Budget.

The Deficit Reduction Package

Bruce Bartlett focused almost exclusively on the deficit reduction package then being negotiated by the Administration and Congress. Noting that failure to agree would intensify the impression that the President and the legislators were in a state of gridlock, Bartlett argued, "Merely reaching some kind of meaningful agreement with the Democratically controlled Congress sends an important message to the world that President Reagan and the Congress can work together to solve important national problems."

Charging that "Congress appears to be disinclined to do more than it has done to cut spending," Bartlett concluded pessimistically that "the best we can probably hope for in the near term is to keep the deficit from rising above 1987's levels."

Taxes and the Deficit

"Where we go from here on the tax side" furnished Harvey Galper with the theme of his conference paper. "Let me begin my remarks with a bold statement," he said. "You can debate it if you want, but at least I'm convinced. The statement is this: We will not succeed in reducing the federal deficit to levels that we would all find acceptable without a significant tax increase." The tax expert from Peat Marwick Main & Co. said he was convinced of the need "to determine the amount and kind of tax increase we will be willing to accept if we are serious about making substantial inroads on the budget deficit." He proposed — "for argument's sake" — tax increases on the order of 1 % of GNP, or $50 - 55 billion, by 1990.

(Continued on page 6)

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Congress Bashing"

When a pitcher throws a ball low, and slow, the only thing to do is hit it out of the park. When a public institution continually shows its worst side, it provides a field-day for cartoonists, standup comics and late night talk show hosts.

That seems to have become the status of the United States Congress whose antics would be laughable if they didn't so directly impact the fate of 242 million Americans and, ultimately, 4.9 billion human beings. Considering both the questionable spending reductions and haphazard tax legislating in this last round, it could be argued fairly that we would have been better off just letting the Grammm-Rudman-Hollings sequester take effect. And while Congress spent the entire year arguing over the budget, it failed to move at all on many pieces of vital legislation. In short, Congress is in danger of becoming a parody of itself, a guarantee of full employment for political satirists of all persuasions.

Democracy is inherently messy. It lacks the spit and polish of totalitarianism. Maybe that's why in the old war movies the Nazis always had the best uniforms and the shiniest tanks and planes, while the sloppy, disorganized GIs barely managed to muddle through to victory with their shirttails hanging out.

There are grounds for arguing that the Founding Fathers, in designing the Constitution they bequeathed to us two centuries ago, built into that unique instrument guarantees that our representative form of government would remain chaotic and bumptious. Certainly, they deliberately chose to avoid the elegant foppery of the courts of 18th century Europe. Homespun cloth and muddy boots were more the uniform of the day at the Constitutional Convention than satins and powdered wigs.

Granting that our political structures represent a triumph of the common man, one cannot help wishing that those who hold public office might be just a little less "common." We deserve better of them. They deserve better of themselves.

A number of legislators have already declared their unwillingness to seek reelection to the House or Senate. Explicitly, or between the lines, it is possible to detect that they, themselves, are fed up with the pervasive lack of respect shown toward the nation's highest legislative body. National office has not only ceased to be fulfilling — or fun. It is also in imminent danger of becoming ludicrous.

An earlier generation of Americans rescued the political process from the smoke-filled rooms and machine politics. The present generation had better find a way to rescue the politicians from themselves before lawmaking again becomes so tainted that it will be left to those considered too inept to hold down a "real" job.

John Wesley Hanes, Sr.

John W. Hanes, Sr., widely known as a public official during the Roosevelt Administration and as a civic-minded corporate executive, died December 24 at the age of 95.

Mr. Hanes joined the Tax Foundation's Board of Directors in 1945, served as chairman from 1947 to 1957, and since then as Chairman of the Executive Committe and Honorary Chairman.

George Grayson Tyler

George Grayson Tyler, a former head of the tax department of the law firm of Cravath, Swain & Moore and for 22 years a trustee of the Tax Foundation, died of a heart attack on January 4. He was 81 years old.

An expert in the field of corporate tax, Mr. Tyler's clients included Chemical Bank, Exxon, Time Inc. and Westinghouse.

(CONFERENCE, *from page 5*)

Four Possible Approaches

Galper listed four possible ways to raising new revenues: broadening the tax base; raising tax rates; miscellaneous taxes, which he called "cats and dogs or odds and ends"; and introducing a new revenue source. "Various combinations of these are also possible," he added. After discussing tax options under each approach, and outlining possible alternative Republican and Democratic strategies, depending on the 1988 election results, he concluded, "I would rather see a continuing reliance on broad-based income taxes, even if we have to have higher tax rates in order to do it." He argued that it would be possible to raise "something like $30 billion from rate increases," adding that his preference was "to go even further on the income tax side, upwards of $40 - 45 billion." Galper opposed moving in the direction of a value-added tax, both because of its potential impact on the tax structure and because of "what it might also portend for future spending increases as well."

The Budget Process

How budgets are constructed was discussed by Allen Schick in the final talk of the morning. He approached the topic from both a short-term and a longer term perspective, finding a great deal of fault with the short-term agreement then undergoing ratification. "There's less deficit reduction than if nothing happened and the automatic sequestration had taken place," he charged. He went on to point out that there is "a very good chance" that the fiscal 1988 deficit will be higher than the fiscal 1987 deficit, and "then we'll have again the problem of a reversal of expectations and disappointment."

A Failed Summit

Schick faulted the budget summit meeting between the Administration and the Congress for failing to achieve the one thing only a summit could have achieved: "to deal with entitlements, particularly social security... That's what they needed a summit conference for and that's what they didn't touch." Schick also foresaw enforcing the agreement as another short-term problem.

The Long-Term Problem

Describing the long-term consequences of budget deficits as "much more worrisome," Schick reviewed the history of the growth of public spending, linking it with a period in the nation's life when the economy was in a high-growth mode of 4 to 5 percent a year. "We learned how, through our budget procedures, to spend that 4 to 5 percent a year," he explained. Then came a situation in 1985 and 1986 when the economy was growing at 2 to 2 1/2 percent a year. Despite the record length for a peacetime expansion, "we have these massive structural deficits of about $175 billion, close to more than 4 percent of GNP... We didn't grow out of the deficit despite five consecutive years of growth for a very simple reason," he pointed out. "If our political budget structure is geared to grow in spending terms at 4 percent a year and the economy is only growing at 2 1/2 percent, that means a deficit." This creates a situation, he explained, where the deficit will continue to grow larger because "we have become accustomed to spending more."

Resolving the Dilemma

"The long-term solution," Schick said, "that we must find is to reconcile the contradictions in public opinion between spending more and having a smaller government and also by reconciling the growth in government with the growth in the economy." He added that he was pessimistic about this happening, because the national expectation is for spending to continue to grow at a greater rate than the economy and because "the demographics are working against us." Schick foresaw the need for a political trade if a solution is to be achieved, a trade in which social security taxes and benefits would be adjusted downward in exchange for increases in general taxation.

Tax Policy Post Reform

The present and future impact of the massive revisions contained in the Tax Reform Act of 1986 (TRA86) came under examination in the afternoon session of the Conference. Wilfred Tremblay, Vice President-Taxes, M.A. Hanna Company, and a member of the Tax Foundation's Advisory Council, chaired the session.

A Positive Step

While he expressed some reservations about the Tax Reform Act of 1986, J. Roger Mentz, a tax lawyer with the Washington firm of Cadwalader, Wickersham & Taft who served in the Treasury's Office of Tax Policy as the 1986 bill was being developed, told the conference, "I think tax reform on the whole is a very major positive step for our income tax system." He singled out the two major accomplishments of the landmark legislation: "the virtual elimination of individual income tax shelters"; and the "major antipoverty program" involved in removing a number of low earners from the tax rolls or "dramatically" lowering their income taxes.

"Was it the best bill that could have possibly been conceived?" he asked. "No. But was it the best bill that the political system could have enacted? Yes." He added, "Those of you who

(Continued on page 7)

On the long-term budget deficit:

"... massive deficits pose two serious threats that cannot be ignored: a temptation to try to inflate our way out of the problem by monetizing the deficits...[and] not so dramatic ... but just as debilitating, the drain on our supply of savings that would otherwise be available to finance new capital formation."

– Edgar Fiedler

(CONFERENCE, *from page 6*)

are deeply involved in your corporation's tax problems or are practicing law and are working with the Tax Reform Act know that there are a lot of rough edges that have to be fixed."

Part of the fixing, Mentz described as "technical corrections," but he also emphasized "there are other maybe not-so-technical corrections that also need fixing." He emphasized strongly the need to deal with what he called "this straight-jacket of revenue constraints, Gramm-Rudman constraints."

Pressure for Revenues

David Brockway, chairman of the Joint Committee on Taxation, followed Mentz, with a prediction that "great pressure" for more tax revenues, driven by "the enormous deficit," would likely result in base broadening. He indicated that he saw no chance for major increases in excise taxes, significant rate increases, or a value-added tax without strong presidential leadership. "Congress is not structured to go forward by itself in making those kinds of politically unpalatable changes without the administration going along with it," he noted.

On the budget summit:

"To deal with entitlements, particluarly social security – that's what they needed a conference for and that's what they didn't touch."

– Allen Schick

Focusing on the problems that so many tax changes create for the professional tax staff of the Congress, Brockway concluded, "It is a very difficult environment for us, as it is for the taxpayers, when we have tax policy driving changes in the base, major changes in the base, every year. As I say, I expect that to be what we're facing for the next few years."

Special Recognition

A highlight of the afternoon was presentation of special public service acknowledgments to both the Joint Committee on Taxation and the Office of Tax Policy of the Department of the Treasury.

Covering Tax Policy

Jeffrey H. Birnbaum, chief congressional correspondent for the Wall Street Journal, was featured speaker at the conference luncheon, which was chaired by Tax Foundation Trustee M. Alanson Johnson, II, Treasurer of the P.H. Glatfelter Company. Birnbaum discussed the evolution of the 1986 tax bill, the history of which he coauthored with Alan Murray in his book *Showdown at Gucci Gulch*.

"I believe tax reform passed," Birmbaum said, "not because anyone really wanted it — indeed, it was the bill that nobody wanted — it succeeded because so few people were willing to kill it once it got rolling. Put another way, no one wanted the dog to die on his doorstep."

Birnbaum said that "even the men who shepherded the bill forward — Treasury Secretary James Baker, Senate Finance chairman, at the time, Bob Packwood, and House Ways and Means Chairman Dan Rostenkowski — approached the task reluctantly. The only constituency for reform was the great mass of voters who paid their taxes each year without the benefits of shelters and tax gimmicks, and even they were skeptical."

Public Service Award

Senator Daniel Patrick Moynihan, senior Senator from New York, was honored at the Foundation's 50th Anniversary dinner that evening. Introducing Moynihan, Hans W. Wanders, President of The Wachovia Corporation and Chairman of the Foundation, noted "In considering who should receive the Tax Foundation's Distinguished Public Service Award on the occasion of our 50th anniversary, the trustees were especially desirous of honoring an individual whose public career mirrors the ideal expressed in the Foundation's motto — 'Toward Better Government Through Citizen Understanding.' And who would be more appropriately recognized than the distinguished senior Senator from the State of New York? And how appropriate it is that the Tax Foundation, which was founded in New York, recognizes on this occasion an individual who has served his state so well."

A Real Public Service

"You really are a public service," Moynihan replied, "at a time when, by your own accounts, it would be a very misguided public person indeed who placed any high level of confidence in the official data of the United States. . .

"There is one standard of disinterested objectivity which is maintained and which is accessible to laymen such as I, and those are the reports of the Tax Foundation. We read them, and we trust them. It takes half a century to gain that kind of trust, and it should be treasured."

The bulk of the Senator's address was devoted to the "how our public finances have come to such present desolation . . . the origins of our present crisis." He attributed this crisis to a failure to link the enormous tax cuts of the early Reagan years with corresponding spending restraint.

On tax planning:

"It is a very difficult environment for . . . taxpayers, when we have tax policy driving major changes in the base every year."

– David Brockway

"In 1981 the United States was not about to be driven into the sea," he noted, "but it could happen now, if we think it's happening. We could come upon a political Dunkirk. But need we?"

The Senator argued that it is just as possible to solve the trade and budget deficits as it was to restructure the funding of the social security system funding in the early 1980s. "It took us three years to decide to do something to fix it," he pointed out, "but when we did. . . it took. . . exactly 12 days to do it. . . These things are doable when people want them done."

(TAX LEGISLATION, *from page 3*)

taxpayers. The measures passed included a major change in depreciation allowances, extension of IRAs to everyone, bracket indexing, and the general individual rate cuts.

Revenue Raisers

However, such large revenue reductions as envisioned by the 1964 act and particularly ERTA would not be left to run their course. Ironically, the two legislative acts *increasing* total Federal revenues as a percentage of GNP directly followed the two largest revenue reduction acts. Both the Revenue and Expenditure Control Act of 1968 and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) increased total Federal tax revenue well above 1 % of GNP, diminishing the revenue reductions promised by the acts which preceded them in 1964 and 1981. It may be said, "what the Federal government giveth . . . the Federal government taketh away." In fact, the three major acts enacted after ERTA in 1981 have been major revenue raisers (excluding tax provisions for fiscal 1988). TEFRA repealed more than half of the benefits for corporations, the Social Security Amendments of 1983 raised payroll taxes and subjected social security benefits to the income tax for the first time, and the Deficit Reduction Act of 1984 (DEFRA) further reduced corporate depreciation allowances. In fact, the "revenue neutral" Tax Reform Act of 1986 raises an estimated $18.6 billion in revenues in 1987, disproportionately increasing corporate tax revenues by $28.2 billion while reducing individuals' taxes by $10.6 billion. The so-called "great corporate giveaway" of 1981 was taken away before its incentives could ever be fully realized. The dominant motive behind most enacted tax legislation after ERTA was purely and simply to raise dollars.

Seesaw Effect

The net effect of all tax acts since 1981 is revealed in the Exhibit presented in Table 1. The original estimated reductions under ERTA which averaged $260 billion and 5.5% of GNP during each year between 1986-1990 translate into only $149 billion and 3.1% of GNP for the same period by 1986. Further examination of the net revenue effect since ERTA reveals an astonishing reversal in the corporate tax cuts. In 1981, ERTA promised estimated corporate tax reductions averaging $51 billion in years 1987-1989; however, by 1986 subsequent tax acts parlayed this reduction into an estimated $20 billion revenue increase in each of the same years. In the final analysis, 43% of the total tax reductions granted by ERTA for the period of 1986-1990 has thus far been eroded by subsequent tax acts.

The history of major tax legislation since 1964 represents a seesaw of revenue decreases and increases without any apparent consistency from a Federal tax policy viewpoint. Unfortunately, this history seems bound to continue. Congress is now facing the real dilemma of reducing the huge deficits projected well into the future while trying to encourage savings and economic growth. Revenue increases will certainly be part of the picture, and continued tinkering with the tax system as illustrated by the pattern that has prevailed since 1964 seems inevitable.

Now Available
from the
Tax Foundation

The Competitive Burden:
Tax Treatment
Of U.S. Multinationals

by Arthur Young & Company

64 pages
$6 plus $1 postage and handling

TAX FOUNDATION
One Thomas Circle, N.W., Suite 500, Washington, D.C. 20005

3/30/88 R9050-3

TAX FOUNDATION'S VOL. 32, NO. 2 FEBRUARY/MARCH 1988

TAX·FEATURES

Address Budget and Deficit Issues, Shadow Committee Urges Candidates

1986 Property Tax Growth Outpaces Other Taxes

State and local property tax revenues increased by a hefty 7.7 percent in fiscal year 1986, outpacing the 6.2 percent increase in nonproperty taxes. Property tax payments to state and local governments totaled $111.7 billion in 1986, almost double the $57 billion collected ten years earlier. Fiscal 1986 revenues topped 1985 by $7.9 billion and accounted for 29.9 percent of total state and local tax revenues.

The 7.7 percent growth in property taxes in 1986 exceeded the growth rate in sales taxes (6.9 percent), individual income taxes (6.2 percent) and corporate income tax revenue at 4.1 percent. Over the past decade property tax growth has averaged 7 percent annually.

Major Source of Local Revenues

Property tax remains the leading tax revenue source for local governments providing 74 percent of the total in 1986. Local property tax revenue in 1986 totaled $107.4 billion, up $7.6 billion from 1985. Although most states impose some type of property tax, the levies generally apply to a narrow base and furnish under 2 percent of total state monies.

Slower Growth Per Capita

While total property taxes have risen by nearly 100 percent over the past decade from $57 billion to $111.7 billion, the percentage growth in per capita property taxes has been less — 74 percent, from $266 in 1976 to $463 in 1986.

Moreover, when related to personal income, property taxes have actually declined — from $45 per $1,000 of personal income 10 years ago to $34 in 1986, or 24 percent.

Per Capita Trends

On a per capita basis, Wyoming (with collections of $1,173) and Alaska ($1,084) far outdistanced any other state. In third position was the

(Continued on page 8; complete table on page 6)

Astonishment at the way presidential candidates have dodged the budget and deficit issues is the principal reaction of the Tax Foundation's Shadow Committee on the Federal Budget to the election debate now in progress. "The wishful thinking that pervades the campaign may severely constrict the budgetary options available to the next President," the Committee warns in its February 26 report.

Delaying Hard Choices

The Committee faults the succumbing to election year pressures and the churning out of optimistic deficit projections that even slight underperformance by the economy may subvert. "With the structural deficit hovering around the $150 billion mark, it will not take much of a shortfall in economic performance to push the deficit to new record levels," the report observes.

In essence, official Washington has "offloaded the task of recommending a package of tax increases and/or spending cuts onto an Economic Commission which is scheduled to report shortly after the new President takes office," the Committee says. Meanwhile, the optimistic forecasts contained in the President's Budget for fiscal 1989 have been accepted by all parties in the fiscal debate as a way of postponing the hard choices until after the November elections.

Little Elbow Room

One-time factors such as the 1986 tax bill, asset sales, and rescheduling of payments accounted for about half of the deficit reduction in fiscal 1988. Unemployment probably cannot go much lower. There is little room for further cuts in defense spending, paring of grants to states and localities, or reductions in the operating budgets of Federal agencies, the report notes, pointing out that mandated payments for individuals, together with interest charges, now comprise more than 60 percent of total outlays — a share which is expected to increase in the years ahead.

Compounding this shrinkage in areas where budget cuts have traditionally been found is the illusory impact of large surpluses in

(Continued on page 5)

THIS ISSUE:

PAGE 1:
Shadow Committee
Property Taxes
PAGE 2:
Federal Tax Burden
U.S. Multinationals
PAGE 3:
"Budget Watch"
PAGE 5:
"Front Burner"
INSERT:
Corporate Tax Burden

New Study Hits U.S. Taxation of Multinationals

U.S. multinationals are operating under a significant disadvantage in world markets when compared to competing multinationals of other key international trading nations because of burdensome U.S. tax laws, according to a recent study entitled "The Competitive Burden: Tax Treatment of U.S. Multinationals." The study, believed to be the first to actually compare the competitive effects of tax laws in several countries, was conducted by Arthur Young, the international accounting and consulting firm, and published by the Tax Foundation.

In comparing the tax policies of the United States with those of The Netherlands, Japan and Germany, the study found that U.S. multinationals face a severe competitive disadvantage in world markets because of Federal tax policy enacted over the past 20 years, including the 1986 Tax Reform Act.

In announcing the findings at a press conference in New York City on January 19, William Gladstone, chairman of Arthur Young, said, "Tax law always has been a powerful economic policy-making instrument. The Netherlands, Germany and Japan have adopted tax policies that, to varying degrees, encourage firms to do business overseas. Essentially, the United States has adopted exactly the opposite policy."

Robert C. Brown, president of the Tax Foundation, commented, "At a time when U.S. business is just beginning to show signs of increased export activity, the Tax Reform Act of 1986, on top of prior tax restrictions, delivers a discouraging blow to our ability to compete globally. And this, in turn, will have a negative effect on domestic investment and job opportunities."

According to Ray Haas, the author of the study and an international tax partner of Arthur Young, U.S. tax policy hamstrings U.S. multinationals primarily in three areas: rules relating to exemption or deferral of home

(Continued on page 8)

FY'88 Tax Burden Up $55 Billion; Increase Falls on Corporations

Federal taxes will climb 6.6 percent in the 1988 fiscal year, hitting $885.1 billion, compared with $830.5 billion in FY1987, according to Tax Foundation analysis of the projections in the budget the President sent to Congress last month. For individual taxpayers this represents only a 0.2 percent tax increase over last year. For corporations, the news is much less pleasant. They will take a $105.6 billion hit, a 26 percent jump over fiscal 1987 levels.

Total Tax Burdens

Burdens, predictably, are heaviest in the most populous states. The top ten paying states are:

	($Millions)
California	$ 111,631
New York	77,480
Texas	58,648
Illinois	46,638
Florida	43,585
Pennsylvania	42,622
New Jersey	39,083
Ohio	37,644
Michigan	34,996
Massachusetts	26,456

These "big ten" states will send Uncle Sam $518.8 billion in FY88, 59 percent of all Federal taxes to be collected.

At the lower end of the scale, tax burdens will be lightest on the following nine states, plus the District of Columbia:

	($Millions)
Maine	$ 3,494
District of Columbia	3,155
Delaware	2,648
Idaho	2,632
Alaska	2,560
Montana	2,316
N. Dakota	2,019
S. Dakota	1,872
Vermont	1,710
Wyoming	1,642

These bottom 10 states will pay only 2.7 percent of the total Federal tax burden, a total of $24.0 billion.

Per Capita Tax Burdens

When total Federal taxes paid are ranked according to the per capita burden in a given state, Tax Foundation researchers note an increase of $189 over 1987 amounts. On average, the national per capita Federal tax burden will hit $3,603 in FY88. Individuals carry the largest burden in these ten states:

	($Thousands)
Connecticut	$ 5,410
New Jersey	5,075
District of Columbia	5,057
Massachusetts	4,510
Alaska	4,430
New York	4,339
Maryland	4,303
Delaware	4,106
New Hampshire	4,071
Illinois	4,020

The average Federal tax burden per capita for citizens in the top ten states is $4,532. Lowest burdens, an average of $2,535, are borne by taxpayers in the following ten states:

	($Thousands)
New Mexico	$ 2,664
Alabama	2,657
S. Dakota	2,621
Kentucky	2,591
Idaho	2,581
Arkansas	2,536
West Virginia	2,487
Utah	2,440
Mississippi	2,153

Tax Foundation researchers point out that citizens in the top ten states will pay an average per capita tax burden that is $1,997 higher than citizens in the lowest per capita states.

Note: "Memorandum on the Allocation of the Federal Tax Burden by State, Fiscal Years 1987–89," and "Federal Tax Burdens in States and Metropolitan Areas," which provide a 10-year tax burden history and explain the methodology of the study, are available from the Tax Foundation.

(Complete table on page 7)

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Chairman of the Board	Hans W. Wanders
President	Robert C. Brown
Senior Vice President	Edward A. Sprague
Editor	William J. Wilson
Contributing Editor	Allen Schick
Contributing Economist	Paul G. Merski
Consulting Economist	Elsie M. Watters
Publications Specialist	William Ahern

Tax Foundation
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
(202) 822-9050

Budget Watch By Allen Schick

Making Elderly Americans Dependent on Government Assistance

Judging from its policies, the Federal government prefers that older persons be dependent on it for assistance rather than be able to finance their own needs. This attitude is reflected in the taxes levied on the elderly and in the benefits provided to them. Whatever its objectives, this policy has two adverse consequences: (1) the aged must rely on Washington for an increasing portion of their income; and (2) the Federal government is burdened by soaring costs of assistance to the elderly.

Taxing the Elderly

Reductions in marginal income tax rates has been one of the foremost accomplishments of the 1980s. At the start of the decade, these rates were as high as 50 percent on "earned" income and 70 percent on investment income. Marginal rates were lowered by legislation enacted in 1981 and 1986. The highest nominal rate in tax year '88 will be only 28 percent, though many upper middle class taxpayers will pay a top marginal rate of 33 percent.

But while overall tax rates have been lowered, Americans above the age of 65 can bear extraordinarily high tax burdens. Many now have marginal rates above the 1980 levels, making them the only major group facing this predicament. Three tax provisions—one predating the 1980s and two recent developments—account for this situation. Moreover, pending legislation that is likely to be enacted before this year's election will raise the marginal burden on the elderly even higher.

. . . the aged must rely on Washington for an increasing portion of their income . . .

■ Workers between the ages of 65 and 69 face loss of social security benefits if they earn more than $8,400 a year. Their benefits are reduced by $1 for every $2 earned above that amount. No benefits are provided to those who make above $20,000. This penalty is equivalent to a 50 percent tax rate, far above the rate levied on the wealthiest taxpayers. On average, elderly workers risk losing thousands in annual social security payments.

. . . while overall tax rates have been lowered, Americans above the age of 65 continue to bear extraordinarily high tax burdens.

■ Since 1983, half of the social security benefits have been treated as taxable income for single taxpayers making more than $25,000 a year and for households with income in excess of $32,000. These income levels have not been indexed; as a result, the number of elderly who have their benefits taxed will steadily rise in the years ahead. It should be noted that proposals in Congress would tax all social security payments for persons above these income brackets.

■ The monthly Part B medicare premium (for supplementary medical insurance) has nearly tripled in this decade from $8.70 in 1980 to $24.80 in 1988. This growth rate has been more than three times the increase in social security benefits. A retired person who earned the minimum wage while working now uses 5.3 percent of his social security check for the Part B premium, up from 2.9 percent at the start of the decade.

■ Pending legislation to expand medicare coverage would increase the monthly premium and also establish an additional income-based premium. By 1992, when the legislation would be fully effective, the House-passed bill would raise premiums for all elderly persons by $5.70 a month; the Senate-passed version would raise the payments by $9.70 a month. Each version would also impose a graduated premium based on income that would be as much as $1,000 a year for persons of relatively modest means by 1992. The House would link this premium to adjusted gross income; the Senate would impose a surtax amounting to about 10 percent on elderly taxpayers. The House measure has two features which would make it more burdensome than the Senate bill. First, the graduated premium would not be deductible as a medical expense; second, medicare participants would not be able to avoid this additional tax by withdrawing from the Part B program.

These four factors add up to a heavy burden on many elderly Americans. The net effect is to encourage them to be dependent. If they work after retirement, they lose social security benefits and pay higher medical premiums; if they save before retirement, they pay the higher premiums and are taxed on half their social security payments. Although only a minority of the elderly are in

Workers between the ages of 65 and 69 have their benefits . . . reduced by $1 for every $2 earned above $8,400 . . . equivalent to a 50 percent tax rate, far above the rate levied on the wealthiest taxpayers.

(Continued on page 4)

(BUDGET WATCH, *from page 3*)
this particular predicament, this is because so many of them have become dependent on the government for financial assistance.

The Burden on Government

Taxes are only one side of the financial relationship between older Americans and government. The other side consists of the benefits paid for by public expenditure. Over the years, an increasing share of the Federal budget has been allocated to programs directly serving the elderly. The portion of Federal outlays going to these programs has nearly doubled from 15 percent in 1960 to almost 30 percent today. The share of domestic spending earmarked to the elderly is approaching the 50 percent mark. The accompanying table identifies the direct assistance provided to the elderly. It should not be surprising that the largest share goes to social security. All told, this and other retirement benefits take two-thirds of the aid to elderly persons. A little more than one quarter goes for financing or providing health care. Additional amounts finance housing, social services, and other programs.

Federal Outlays Directly Benefitting the Elderly

Fiscal Year 1986
($Billions)

Social security	$ 146.2	
Supplemental Security Income	3.7	
Veterans compensation-pensions	6.1	
Other retired & disabled	25.9	
Total retirement/disability		$ 181.9
Medicare	64.4	
Medicaid	8.9	
Other health programs	4.7	
Total health		78.0
Housing programs	5.4	
Social services	1.8	
Low-income food & energy assistance	1.2	
Miscellaneous	1.2	
Total other programs		9.6
Total direct assistance to elderly		$ 269.5

Source: US Office of Management and Budget

The portion of Federal outlays going to programs [for the elderly] has nearly doubled from 15 percent in 1960 to almost 30 percent today.

The share of the budget going to the elderly will rise in coming decades even if benefits are not improved. The linkage of social security payments to wages and prices will add to budget outlays, as will the growing number of elderly Americans. Current projections are that nominal expenditures will rise to $1.8 trillion a year by 2020; in constant (1987) dollars they will reach almost $500 billion, more than double current levels. Additional pressure will come from escalating health costs. Since Medicare and Medicaid were established in 1965, these costs have persistently increased faster than the overall inflation rate. With the prospective expansion of medicare coverage, Federal outlays for this program will become an even more prominent part of the budget.

Growing Old and Dependent

Higher taxes and higher benefits translate into growing dependency. According to the Department of Health and Human Services, social security has become the leading source of income for the elderly while earnings have declined in importance. Social security now provides 32 percent of the income for families headed by a person 65 or older, compared to only 23 percent in the late 1960s. During the past two decades, however, earnings have dropped from almost half of the income of these families to less than 30 percent.

The reliability of these figures is problematic because there is reason to believe that many elderly participate in the underground economy, receiving cash or other unreported income to escape the tax burdens discussed earlier. Other elderly forgo work opportunities in order to protect their benefits or to ease their tax burdens.

Thus far, dependency has been a good deal for most elderly. Recent retirees can expect to receive social security benefits far greater than the investment yield of the taxes they paid while working plus the employer contributions. Future recipients will get a worse deal from social security; many may not recover the value of the taxes paid plus interest.

Unless the government alters its policy, the outlook for the elderly will become increasingly bleak in the next century. Those who save for old age will be penalized, as will persons who continue working after reaching retirement age. Those who opt for dependency will find fewer taxpayers contributing to their support, as the ratio of workers to social security recipients drops from 3.3 to 1 in 1987 to a projected 1.9 to 1 by the year 2030. About that time, the social security trust fund will begin paying hundreds of billions of dollars each year in excess of income until it is depleted by the middle of the 21st century. No one can foresee what will happen if and when that occurs, but one thing is certain. Tens of millions of older Americans will learn that dependency is not such a good deal after all.

. . . elderly forgo work opportunities in order to protect their benefits or to ease their tax burdens.

TAX FOUNDATION
ONE THOMAS CIRCLE, N.W., SUITE 500

WASHINGTON, DC 20005
TELEPHONE 202-822-9050

FEDERAL TAX POLICY MEMO

Editor: Edward A. Sprague, Senior Vice President—Program Planning and Tax Policy

FEBRUARY/MARCH 1988

Corporate Tax Burdens

With the approach of the 1988 Presidential election, we can expect some familiar refrains about taxes and the corporate sector. We will hear again about the great corporate "giveaway" of 1981 and how so many large profitable corporations are getting away with little or no income tax liability. Stale as these themes are, they have been repeated so often they take on a life of their own despite convincing evidence to the contrary.

First, there was a significant corporate tax cut enacted under the Economic Recovery Tax Act of 1981 (ERTA). *If* it had been allowed to take effect fully, it would have substantially reduced overall corporate income tax liabilities in the 1980s. But that didn't happen. Instead there were contravening major tax bills starting with TEFRA in 1982 and culminating with the Tax Reform Act of 1986 which obliterated the capital recovery and business tax relief of 1981 and, instead, piled on significant *net* increases in corporate tax liabilities after fiscal 1986. More recently further increases in corporate income taxes have occurred as a result of the Omnibus Budget Reconciliation Act of 1987 and the Continuing Resolution for 1988. This is shown in Table I comparing the effect of major enacted legislation in the 1981–1987 period on individual and corporate income taxes currently and projected through 1991. Individuals did experience marked income tax reductions for the period but the corporate sector was another story.

Corporate Share of Income Taxes

What about the corporate "share" of the income tax burden? Over the long term it has shrunk as a share of total income taxes, but with some special factors affecting the trend.

As Table II indicates, there was a precipitous dropoff in corporate income tax receipts, both absolutely and as a percentage of total income taxes in fiscal 1982 and 1983. Corporate receipts fluctuate more widely than individual receipts anyway, and the severe recession of 1981-1982 had its maximum impact on revenues in fiscal 1982 and 1983. This was also the period when the Accelerated Cost Recovery System (ACRS) first took hold. More rapid depreciation, of course, helped depress tax collections initially, although this would tend to be made up in later years.

In the last four fiscal years, corporate income tax receipts increased sharply, shooting to a record $84 billion in fiscal 1987 and to an estimated $106 billion in fiscal 1988. The revenue recovery has coincided with better business conditions and, of course, the implementation of the 1982, 1984, and 1986 tax bills.

Critical factors in the balance of corporate versus individual taxes are both the level of corporate profits and their share of the national income. The trend in corporate profits as a percentage of national income has been irregularly downward since the 1950s. In fact, the downtrend has closely paralleled that of corporate tax receipts as a percent of total income taxes through 1986. This alone explains much of the long term decline in the proportion of corporate income taxes.

Table I

Effect of Major Legislation, Enacted 1981–1987, on Individual and Corporate Income Tax Receipts

Fiscal Years 1987–1991

($Billions)

Income Tax	1987	1988	1989	1990	1991	1986–1991
Individual	-158.7	-193.1	-224.8	-250.2	-278.3	-1,239.5
Corporate	+9.7	+24.2	+26.8	+33.1	+41.0	+159.6

Source: Budget of the U.S. Government, FY 1989

Table II

Federal Corporate Income Tax Receipts

Selected Fiscal Years, 1950–1988

Year	$Billions	% of Total Income Tax Receipts	Year	$Billions	% of Total Income Tax Receipts
1950	$ 10.4	39.9%	1977	$ 54.9	25.8%
1955	17.9	38.3	1978	60.0	24.9
1960	21.5	34.6	1979	65.7	23.2
1965	25.5	34.3	1980	64.6	20.9
1970	32.8	26.6	1981	61.1	17.6
1971	26.8	23.7	1982	49.2	14.2
1972	32.2	25.3	1983	37.0	11.4
1973	36.2	25.9	1984	56.9	16.1
1974	38.6	24.5	1985	61.3	15.5
1975	40.6	24.9	1986	63.1	15.3
1976	41.4	23.9	1987	83.9	17.6
			1988(e)	105.6	21.2

Source: Economic Reports of The President.

Effective Rates of Tax

What about reports of low or negative rates of tax for specific corporations or industry sectors? The measurement of effective rates of corporate taxation can involve controversial issues. Some reports showing low effective rates for corporations with "economic income" ran roughshod over the measurement problems. But whatever the circumstances of individual firms, the effective rate of the Federal corporate income tax for all corporations is running about the same level as the early 1970s.

Federal income taxes are only part of the picture. Table III illustrates the overall effective rate of federal corporate income tax and rates when that tax is combined with state/local corporate income taxes and corporate payroll taxes. It is true that such

Material in Federal Tax Policy Memo *may be reproduced freely. Credit to Tax Foundation would be appreciated.*

payments can be deducted for federal corporate income tax purposes, but they are a very substantial burden nonetheless.

For comparability, corporate tax accruals net of Federal Reserve earnings are used instead of actual tax receipts. Given today's full acceleration of corporate tax payments, the accruals figures conceptually are very close to tax payments.

While Federal corporate income taxes have risen almost 70 percent in the last decade, state/local corporate income taxes have increased 139 percent for the decade and in 1987 totaled a 30 percentof the federal levy. The combined federal and state/local corporate income tax rate has risen significantly since 1979, surpassing the level of the early 1970s.

The largest element of the business tax burden, however, is now the payroll tax sector, particularly for federal social security and hospital insurance but also for state unemployment insurance and other social insurance funds. These taxes are not imposed on net income, and some economists argue that even the employer share of payroll taxes is borne by employees in lower-than-otherwise compensation. But payroll taxes are a cost of doing business and, particularly in labor-intensive industries, constitute a very large burden. Where labor is relatively scarce and/or subject to rigidities in compensation, that burden may have been absorbed by the employer.

The corporate share of payroll taxes has outstripped corporate income taxes and now runs about $122 billion. When the corporate share of payroll taxes is combined with corporate income taxes, it reached an amount equivalent to 94 percent of corporate profits in 1987.

Unfortunately, most discussion of corporate tax burdens has been based on political perceptions rather than economic reality. The ultimate burden or incidence of corporate taxes is always borne by people, not inanimate corporate structures. Investors, workers, or consumers will bear the burden, depending on the economic circumstances of the industry. Because the precise proportions are unknown and the process is obscured from public view, the corporate income tax is a hidden tax and, as such, always more susceptible to political manipulation.

As long as Congress and the Administration insist on revenue counting and estimating procedures showing "individual effects" and "corporate effects," we are forced to go along with the half-truth of the corporate tax burden as an entity in itself. But however defined, it is obvious that that burden is large and growing.

Table III
Total Before-Tax Corporate Profits
Selected Years, 1950-1987

Year	$Billions	% of Total National Income	Year	$Billions	% of Total National Income
1950	$ 42.9	18.0	1977	$ 200.4	12.4
1955	49.2	14.6	1978	233.5	12.7
1960	49.9	11.7	1979	257.2	12.6
1965	77.4	13.2	1980	237.1	10.8
1970	76.0	9.1	1981	226.5	9.3
1971	87.3	9.7	1982	169.6	6.7
1972	101.5	10.2	1983	207.6	7.6
1973	127.2	11.3	1984	240.0	7.9
1974	138.9	11.5	1985	224.8	7.0
1975	134.8	10.4	1986	231.9	6.8
1976	170.3	11.8	1987	275.7	7.6

Source: Department of Commerce, Bureau of Economic Analysis.

Table IV
Federal and State/Local Corporate Income Taxes and Corporate Payroll Taxes
National Income Accounts Series
(1970–1987)
(Dollar Figures in Billions)

Year	A Corporate Profits Net of Federal Reserve Earnings	B Federal Corporate Income Tax Accruals	C Effective Rate of Federal Tax (B/A)	D State/Local Corporate Income Tax Accruals	E Effective Rate of Federal and State/Local Tax (B+D/A)	F Corporate Payroll Taxes[1]	G Income and Payroll Taxes as % of Corp. Profits (B+D+F/A)
1970[2]	$ 72.4	$ 27.1	37.4%	$ 3.7	42.5%	—	—
1971	84.0	30.1	35.8	4.3	41.0	—	—
1972	98.1	33.4	34.0	5.3	39.4	$ 22.7	62.6%
1973	122.7	39.0	31.8	6.0	36.7	29.5	60.7
1974	133.2	39.5	29.7	6.7	34.7	33.2	59.6
1975	129.1	38.2	29.6	7.3	35.2	33.6	61.3
1976	164.3	48.7	29.6	9.6	35.5	39.8	59.7
1977	194.2	55.7	28.7	11.4	34.6	45.4	57.9
1978	225.8	64.4	28.5	12.1	33.9	53.7	57.7
1979	247.6	65.1	26.3	13.6	31.8	62.2	56.9
1980	225.2	58.6	26.0	14.5	32.5	66.6	62.0
1981	212.0	51.7	24.4	15.4	31.7	77.6	68.3
1982	154.2	33.8	21.9	14.0	31.0	81.7	84.0
1983	192.8	47.1	24.4	15.9	32.7	89.0	78.8
1984	223.3	59.1	26.5	18.7	34.8	104.4	81.6
1985	208.0	58.3	28.0	20.6	37.9	110.4	91.0
1986	215.9	65.9	30.5	21.3	40.4	115.6	93.9
1987(e)	259.7	93.8	36.1	27.2	46.6	121.8	93.5

[1] Includes corporate employer share of OASDHI, state unemployment insurance tax, federal unemployment tax, railroad unemployment insurance and retirement, and workers' compensation.
[2] Includes some effect from Vietnam period surcharge.
Sources: Economic Reports of the President, various years, and unpublished statistics of the Department of Commerce, Bureau of Economic Analysis.

(SHADOW COMMITTEE, *from page 1*)

the Social Security Trust Funds on Federal Budget totals — illusory, because the present buildup will be dissipated in less than a decade when the baby-boom generation begins to retire around 2020. In addition, new increases in Federal spending on space exploration, education, and science research may be just the leading edge of a wave of demands for hikes in spending for child care, housing, and other domestic programs.

Ignoring the Issue

Hence, the Shadow Budget Committee's chagrin over the absence of fiscal policy in the presidential debates. Hence, the Committee's warning, "The wishful thinking that pervades the campaign may severely constrict the budgetary options available to the next President. The Shadow Committee believes that parties and their candidates must play an active role in educating the American people about the need to pay for the things they want. If they fail to do so, the United States will enter the 21st century burdened by the deficits of escapist budgets."

* * *

The Shadow Committee on the Federal Budget is a citizens' watchdog group acting under the auspices of the Tax Foundation. Members of the Shadow Budget Committee are: The Honorable Harry F. Byrd, Jr.; W. Bowman Cutter, Partner, Coopers & Lybrand; Paul H. O'Neill, Chairman and Chief Executive Officer, Alcoa; Rudolph Penner of the Urban Institute, and Dr. Allen Schick of the School of Public Affairs, University of Maryland.

Now Available
from the
Tax Foundation

The 1989 Budget

A Report by
The Shadow Committee on the Federal Budget

$4 plus $1 postage and handling

THE FRONT BURNER

By Robert C. Brown
President, Tax Foundation

"Teamwork"

Washington finally has a winning team. It won't be found on Capitol Hill or in the White House, but at the far end of East Capitol Street, where RFK Stadium is located. How the Washington Redskins defied the oddsmakers and smashed the Denver Broncos to win a huge upset victory in Superbowl XXII contrasts sharply with the way power politics usually works in our nation's capital. Late in the first quarter, Redskin quarterback Doug Williams went down with what looked like a game-ending injury. After missing two plays, Williams returned to the game, played hurt, and produced a record-breaking second quarter and, ultimately, victory.

"Toward the end of the second quarter, I was in tremendous pain." he later told a packed house at Howard University. "I asked the offensive line to just give me a little more time. They told me, 'Don't worry, Doug.' Then the receivers and the defense did what they had to do.

"I'm standing here today, but I am not standing alone."

Courage, humility, and cooperation marked the Redskin triumph. These are rare virtues anywhere. In the world of elected officialdom, particularly in the early days of a presidential and congressional election year, they are virtually nonexistent.

How many politicians will play hurt — especially if the hurt is likely to occur at the ballot box or in the campaign war chest?

While self-deprecation is usually paid lip service on appropriate ceremonial occasions, does any politician in Washington truly believe he can't go it alone? Yet, not standing alone was the key to Superbowl XXII — again, in sharp contrast to Washington politics, where colossal egos clash in arguably splendid isolation.

Even if a sincere request for help were forthcoming in this town, what cooperation could be expected? Washington is legendary for the intensity of its political infighting. The shortest path to power is widely perceived to be up someone's back.

Competition is fine. On one level, that's what superbowls — and politics — are all about. Teamwork doesn't exclude going all out to make the starting lineup. However, what teamwork does call for — and where official Washington has fallen woefully short in recent years — is an awareness that, on game day, we're all part of a team. If the team loses, all lose.

The on-going budget fiasco is one major area where we are losing and losing big. Events are already confirming the skepticism voiced last fall by the Tax Foundation's Shadow Committee on the Federal Budget. We haven't a chance in a million of hitting FY88 deficit reduction targets. Of course, the Washington power-brokers and pundits have their answers ready. The October 19th market collapse and a slowing economy this year have become scapegoats for the shortfall. Few, if any, will concede the possibility that the market and the economy are simply reacting to the national government's woeful performance on tax and fiscal policy.

Official Washington needs to learn what all championship teams learn sooner or later: Competition may get you to the Big Game. But cooperation wins it. That's the reason we are still losing — and losing big — in the battle of the deficits. In the battle of the budget, there are no champions anywhere along Pennsylvania Avenue.

(PROPERTY TAXES, *from page 1*)

Property Tax Collections by State, Per Capita and Per $1,000 of Personal Income

Fiscal Years 1976 and 1986

State	Per Capita Property Tax				Property Tax Per $1,000 of Personal Income			
	Amount		Percent Change	Rank 1986	Amount		Percent Change	Rank 1986
	1976	1986			1976	1986		
Total	$ 266	$ 463	74.1%	—	$ 45	$ 34	-24.4%	—
Alabama	57	118	107.0	51	13	11	-15.4	51
Alaska	1,048	1,084	3.4	2	120	61	-49.2	2
Arizona	282	422	49.6	27	54	34	-37.0	25
Arkansas	101	182	80.2	49	22	17	-22.7	47
California	415	451	8.7	24	64	29	-54.7	32
Colorado	271	521	92.3	20	46	36	-21.7	23
Connecticut	369	731	98.1	7	53	41	-22.6	16
Delaware	130	223	71.5	44	19	16	-15.8	49
Florida	191	411	115.2	28	34	31	-8.8	28
Georgia	178	329	84.8	36	35	27	-22.9	36
Hawaii	174	314	80.5	37	27	23	-14.8	41
Idaho	190	299	57.4	38	37	27	-27.0	35
Illinois	284	539	89.8	17	42	37	-11.9	22
Indiana	226	393	73.9	31	40	32	-20.0	27
Iowa	278	544	95.7	16	46	43	-6.5	14
Kansas	274	533	94.5	18	46	39	-15.2	19
Kentucky	105	195	85.7	47	22	18	-18.2	46
Louisiana	90	189	110.0	48	19	17	-10.5	48
Maine	297	478	60.9	22	63	41	-34.9	17
Maryland	239	438	83.3	26	37	28	-24.3	33
Massachusetts	431	601	39.4	12	70	37	-47.1	21
Michigan	324	650	100.6	10	52	48	-7.7	6
Minnesota	254	529	108.3	19	44	38	-13.6	20
Mississippi	110	221	100.9	45	27	24	-11.1	38
Missouri	195	243	24.6	41	35	19	-45.7	45
Montana	350	650	85.7	9	65	59	-9.2	3
Nebraska	319	579	81.5	14	53	43	-18.9	12
Nevada	272	340	25.0	35	42	24	-42.9	39
New Hampshire	348	738	112.1	6	66	51	-22.7	5
New Jersey	446	757	69.7	4	67	44	-34.3	11
New Mexico	103	143	38.8	50	22	13	-40.9	50
New York	412	748	81.6	5	63	47	-25.4	7
North Carolina	130	265	103.8	39	26	23	-11.5	40
North Dakota	212	364	71.7	34	37	30	-18.9	29
Ohio	224	394	75.9	30	38	30	-21.1	30
Oklahoma	124	234	88.7	43	24	19	-20.8	44
Oregon	333	651	95.5	8	59	52	-11.9	4
Pennsylvania	176	388	120.5	32	30	29	-3.3	31
Rhode Island	294	624	112.2	11	50	45	-10.0	10
South Carolina	116	260	124.1	40	25	25	0.0	37
South Dakota	288	477	65.6	23	59	43	-27.1	13
Tennessee	129	235	82.2	42	27	21	-22.2	42
Texas	213	517	142.7	21	39	39	0.0	18
Utah	172	366	112.8	33	36	35	-2.8	24
Vermont	308	556	80.5	15	63	46	-27.0	8
Virginia	173	396	128.9	29	30	28	-6.7	34
Washington	236	442	87.3	25	38	32	-15.8	26
West Virginia	106	203	91.5	46	22	20	-9.1	43
Wisconsin	289	600	107.6	13	51	46	-9.8	9
Wyoming	352	1,173	233.2	1	60	88	46.7	1
District of Columbia	210	773	268.1	3	27	43	59.3	15

Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.

(TAX BURDEN, *from page 2*)

Estimated Federal Total and Per Capita Tax Burden by State

Fiscal Years 1987-1989

($Millions)

State	Federal Total Tax Burden			Federal Funds Tax Burden			Per Capita Burden (Dollars)			State Rank 1988	
	1987	1988	1989	1987	1988	1989	1987	1988	1989	Total	Per Capita
U.S.Total	$ 830,536	$ 885,116	$ 940,290	$ 514,478	$ 538,872	$ 570,568	$ 3,414	$ 3,603	$ 3,790	—	—
Alabama	10,209	10,893	11,568	6,072	6,357	6,727	2,505	2,656	2,802	25	43
Alaska	2,419	2,560	2,713	1,464	1,519	1,605	4,358	4,430	4,506	48	5
Arizona	10,209	10,915	11,608	6,368	6,668	7,086	2,991	3,108	3,213	24	33
Arkansas	5,633	6,042	6,421	3,241	3,418	3,623	2,371	2,536	2,690	32	48
California	104,606	111,631	118,703	65,052	68,193	72,221	3,805	3,985	4,158	1	11
Colorado	11,322	12,081	12,843	7,040	7,382	7,818	3,406	3,570	3,728	23	19
Connecticut	16,402	17,398	18,481	10,815	11,261	11,910	5,124	5,410	5,720	16	1
Delaware	2,486	2,648	2,813	1,472	1,538	1,628	3,890	4,106	4,321	44	8
Flordia	40,820	43,585	46,379	27,638	29,054	30,804	3,409	3,547	3,678	5	21
Georgia	18,782	20,023	21,270	11,522	12,042	12,741	3,029	3,177	3,320	12	29
Hawaii	3,449	3,688	3,924	2,057	2,161	2,288	3,206	3,378	3,544	40	24
Idaho	2,455	2,632	2,796	1,369	1,448	1,535	2,428	2,581	2,717	45	47
Illinois	43,850	46,638	49,511	27,231	28,501	30,174	3,789	4,020	4,257	4	10
Indiana	16,590	17,712	18,830	10,305	10,794	11,428	3,012	3,212	3,409	15	27
Iowa	8,208	8,797	9,351	4,862	5,144	5,459	2,887	3,100	3,302	30	34
Kansas	8,285	8,851	9,409	5,089	5,345	5,664	3,349	3,555	3,753	29	20
Kentucky	9,108	9,724	10,325	5,484	5,761	6,101	2,435	2,591	2,742	27	46
Louisiana	11,560	12,315	13,067	7,064	7,402	7,836	2,564	2,726	2,886	22	41
Maine	3,268	3,494	3,712	1,967	2,069	2,192	2,769	2,941	3,104	42	37
Maryland	18,351	19,533	20,757	11,454	11,959	12,654	4,079	4,303	4,533	13	7
Massachusetts	24,874	26,456	28,114	15,991	16,704	17,678	4,254	4,510	4,777	10	4
Michigan	32,959	34,996	37,100	19,793	20,692	21,897	3,609	3,835	4,069	9	12
Minnesota	14,450	15,457	16,434	8,425	8,859	9,387	3,412	3,629	3,838	20	17
Mississippi	5,345	5,723	6,080	3,109	3,269	3,461	2,024	2,153	2,273	33	51
Missouri	16,292	17,397	18,489	10,104	10,609	11,240	3,202	3,401	3,596	17	23
Montana	2,160	2,315	2,460	1,258	1,330	1,412	2,621	2,793	2,946	47	40
Nebraska	4,774	5,126	5,457	2,842	2,999	3,181	2,980	3,188	3,383	34	28
Nevada	3,580	3,794	4,023	2,379	2,481	2,624	3,624	3,738	3,861	39	13
New Hampshire	4,056	4,315	4,588	2,656	2,770	2,930	3,888	4,071	4,260	36	9
New Jersey	36,840	39,083	41,474	23,504	24,525	29,951	4,811	5,075	5,356	7	2
New Mexico	3,822	4,087	4,342	2,291	2,406	2,549	2,538	2,664	2,780	38	42
New York	72,710	77,480	82,374	45,368	47,499	50,300	4,083	4,339	4,601	2	6
North Carolina	17,920	19,124	20,314	10,630	11,129	11,778	2,800	2,955	3,104	14	36
North Dakota	1,887	2,019	2,145	1,151	1,213	1,286	2,763	2,939	3,099	46	38
Ohio	35,304	37,644	39,977	20,994	22,001	23,295	3,284	3,500	3,716	8	22
Oklahoma	9,548	10,173	10,800	5,895	6,166	6,526	2,853	3,000	3,143	26	35
Oregon	8,074	8,635	9,170	4,680	4,935	5,234	2,982	3,175	3,357	31	30
Pennsylvania	40,029	42,622	45,225	24,108	25,287	26,781	3,365	3,579	3,792	6	18
Rhode Island	3,434	3,660	3,886	2,013	2,112	2,237	3,508	3,720	3,929	41	14
South Carolina	8,440	9,019	9,582	4,975	5,214	5,518	2,472	2,610	2,740	28	45
South Dakota	1,737	1,872	1,993	1,014	1,074	1,140	2,443	2,621	2,780	49	44
Tennessee	13,315	14,201	15,086	8,098	8,465	8,955	2,754	2,916	3,076	21	39
Texas	55,196	58,648	62,260	35,515	37,031	39,164	3,235	3,360	3,486	3	25
Utah	3,940	4,217	4,481	2,271	2,386	2,526	2,323	2,440	2,543	37	50
Vermont	1,603	1,710	1,814	972	1,023	1,084	2,942	3,109	3,268	50	32
Virginia	20,565	21,928	23,318	13,081	13,682	14,482	3,514	3,702	3,891	11	15
Washington	15,607	16,610	17,624	9,555	10,018	10,610	3,460	3,639	3,817	18	16
West Virginia	4,459	4,755	5,043	2,655	2,788	2,952	2,330	2,487	2,642	35	49
Wisconsin	15,080	16,086	17,064	8,770	9,232	9,785	3,144	3,342	3,534	19	26
Wyoming	1,543	1,642	1,739	953	998	1,057	3,014	3,169	3,319	51	31
Dist. of Columbia	2,973	3,155	3,350	1,856	1,935	2,047	4,757	5,057	5,376	43	3

Source: Total U.S. taxes as shown in the Fiscal Year 1989 Budget of the U.S. Government.
Computations of total and per capita tax burden by state were made by Tax Foundation.

(MULTINATIONALS, *from page 2*)

country tax on foreign operation and income; foreign tax credit utilization rules which determine the ability of a company to avoid double taxation on foreign income; and the extent to which tax treaties modify these rules. Among the major findings are:

1. When exemptions or deferrals, foreign tax credits and tax treaties are taken into account, the U.S. multinationals very well can be at the highest end of the effective tax rate scale on foreign operations compared to the other three countries. In fact, even though the 1986 tax act lowered the nominal corporate tax rates, many U.S. companies will face increased tax liability on foreign source income.

2. The U.S. has no treaty in which it agrees to "spare" U.S. tax on income that could have been but was not taxed by a lesser developed country, while the other three nations have many such "tax sparing" treaties. The absence of such an incentive for U.S. companies hinders their ability to access the low-cost labor and raw materials of Third World countries in a way that would enable these companies to compete equally in world trade.

A major U.S.-based computer manufacturer that sets up a manufacturing facility in Singapore, which grants a tax holiday to such an operation, nevertheless pays the effective corporate U.S. tax rate of 34 percent on repatriated revenues. By comparison, Dutch and German companies enjoy a home country exemption, resulting in a zero percent worldwide tax rate. Japanese companies pay a 56 percent nominal tax rate; however, since Japan has a 33 percent tax sparing credit for Singapore, such a company would pay only a 23 percent effective tax rate.

An additional competitive disadvantage for U.S. multinationals results from the relative instability of the U.S. tax system, with changes to the system occurring or threatened every year or two for the past 20 years. "The ability of U.S. companies to do long-term business planning has been severely hampered for many years because of consistent changes in our tax laws, further weakening our competitive posture worldwide," Gladstone charged.

* * *

Note: Copies of "The Competitive Burden: Tax Treatment of U.S. Multinationals," 64 pages, are available for $6 plus $1 for postage and handling from the Tax Foundation, One Thomas Circle, N.W., Suite 500, Washington, DC 20005. (202) 822-9050

(PROPERTY TAX, *from page 1*)

District of Columbia ($773). States with lowest per capita collections were Alabama ($118), New Mexico ($143), and Arkansas ($182).

In terms of the decade's percentage rate of growth in per capita property taxes, the District of Columbia, Wyoming and Texas headed the list. Altogether, 16 states and the District of Columbia reported a doubling or more in per capita property taxes. No state reported a decline in per capita property taxes between 1976 and 1986.

Per $1,000 of Personal Income

Property taxes per $1,000 of state personal income were highest in Wyoming ($88), Alaska ($61), and Montana ($59) as compared to the national average of $34. The lowest property tax burdens by this yardstick were in Alabama ($11), New Mexico ($13) and Delaware ($16).

During the decade only two jurisdictions experienced increases in property taxes in relation to personal income — the District of Columbia (up 59 percent), and Wyoming (up 47 percent). The sharpest reduction in the taxes/income ratio for the decade occurred in California (down 55 percent), Alaska (49 percent), and Massachusetts (47 percent).

(Complete table on page 6)

TAX FOUNDATION, INCORPORATED
One Thomas Circle, N.W., Suite 500, Washington, D.C. 20005

Ms. Jeanne Long
CONGRESSIONAL RESEARCH SERVICE, INC.
4500 East-West Highway
Bethesda, Maryland 20814